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Decision 06-09-040 September 21, 2006

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Fruitridge Vista Water Company, a trust, for an order: 1) establishing a moratorium on new service connections; and 2) clarification of Tariff Rule 15 regarding payment for new facilities servicing new applicants.	Application 05-10-005 (Filed October 7, 2005)
Sacramento Housing and Redevelopment Agency and the Housing Authority of the County of Sacramento, Complainants, vs. Fruitridge Vista Water Company, Defendant.	Case 05-10-007 (Filed October 11, 2005)
County of Sacramento, Complainant, vs. Fruitridge Vista Water Company, Defendant.	Case 05-10-011 (Filed October 7, 2005)

David R. Gonzalez & Donna L. Gonzalez, Complainants, vs. Fruitridge Vista Water Company, Defendant.	Case 05-09-011 (Filed September 6, 2005)
Mercy Properties California, Complainant, vs. Fruitridge Vista Water Company, Defendant.	Case 05-09-012 (Filed September 6, 2005)
Victoria Station, LLC, Complainant, vs. Fruitridge Vista Water Company, Defendant.	Case 05-09-027 (Filed September 22, 2005)
Park Place LLC, Complainant, vs. Fruitridge Vista Water Company, Defendant.	Case 05-11-015 (Filed November 15, 2005)

ORDER MODIFYING DECISION (D.) 06-04-073, AND DENYING REHEARING, AS MODIFIED

I. INTRODUCTION

In this Order we dispose of the application for rehearing of Decision (D.) 06-04-073 ("Decision") filed by the Division of Ratepayer Advocates ("DRA") and by Assembly Member Dave Jones, David Tamayo, and Paul and Debra McVay (jointly).

On October 7, 2005, Fruitridge Vista Water Company ("Fruitridge Vista")[1] filed application (A.) 05-10-005 seeking approval of a moratorium on new service pursuant to Public Utilities Code section 2708,[2] and requesting clarification of Tariff Rule 15.[3] We consolidated the application with six formal complaints seeking Commission intervention to require Fruitridge Vista to adequately serve its existing customers (approximately 15,000), and provide new service to approximately 550 potential customers as a result of residential and commercial redevelopment projects in Fruitridge Vista's service area.

The application and complaints were preceded by ongoing water system and supply problems so severe that two other agencies issued orders directing Fruitridge Vista to take immediate corrective actions. In January 2003, the Regional Water Quality Control Board ("RWQCB") ordered Fruitridge Vista to develop new water supply necessary to serve current users and new development projects in its service territory. And in August 2005, the Department of Health Services ("DHS") ordered Fruitridge Vista to upgrade or replace its distribution system to provide sufficient water supply and pressure, and to provide additional sources of water. At the time the application and

[1] Fruitridge Vista is a Class B water company serving approximately 15,000 people through 4,947 service connections in a four-square-mile unincorporated area adjacent to the southern boundary of Sacramento.
[2] All section references are to the Public Utilities Code unless otherwise specified.
[3] Tariff Rule 15 applies to the payment for new facilities to serve new applicants for water service.

complaints were filed with the Commission, Fruitridge Vista remained out of compliance with these orders.

On December 6, 2005, the assigned Administrative Law Judge ("ALJ") held a pre-hearing conference to address Fruitridge Vista's application and the consolidated complaints. By agreement of the parties, this proceeding was designated for mediation pursuant to the Commission's adopted Alternative Dispute Resolution ("ADR") Process, and a proposed settlement agreement ("settlement") was subsequently submitted for Commission approval on behalf of the majority of parties to this proceeding.

In D.06-04-073, we approved the proposed settlement which provides for a comprehensive package of water system and supply solutions to achieve compliance with the RWQCB and DHS orders, and resolves all six complaints. Our Decision includes approval of ratemaking treatment in conjunction with the multiple funding sources contemplated under the settlement.[4]

Timely applications for rehearing were filed by the DRA, and by Assembly Member Dave Jones, David Tamayo, and Paul and Debra McVay (jointly). DRA challenges the Decision on the grounds that: (1) the $1.98 million addition to rate base is contrary to ratemaking principles and is not supported by the record; (2) the potential $5 million addition to rate base is contrary to the public interest and is not supported by the record.

Tamayo et al. challenge the Decision on the grounds that: (1) the $1.98 million addition to rate base is contrary to ratemaking principles and existing precedent;

[4] The comprehensive settlement provides for: two new interconnections with the City of Sacramento; purchase of water from the City of Sacramento as needed; construction of three new wells and associated piping and infrastructure; destruction of wells 1, 2, 11, and 12 pursuant to the RWQCB and DHS findings. The total cost of settlement is $12 million, apportioned as $6.3 million in infrastructure costs and $5.7 million associated with buy-in and purchase water costs with the City of Sacramento. Funding for the settlement will be provided by a combination of: the DHS Drinking Water Treatment and Research Fund; the State Revolving Fund zero interest loan; an expected 20-year financing agreement with the City of Sacramento; special facilities fees to be paid by specified developers and future construction; potential monetary recovery associated with Fruitridge Vista's pollution lawsuit for MTBE contamination of wells; and ratepayers.

(2) the Commission failed to comply with necessary procedural requirements; (3) the Decision fails to include findings of fact and conclusions of law on all material issues as required by section 1705; (4) pre-authorizing the potential $5 million addition to rate base is contrary to ratemaking principles and existing precedent; (5) the Decision fails to consider alternatives to ensure that rates are just and reasonable as required by section 451; (6) the Decision fails to minimize long-term costs of reliable water service as required by section 701.10; and (7) the Decision impermissibly binds future Commissions. A joint response to the applications for rehearing was filed by the parties to the settlement ("Settling Parties").

We have carefully considered the arguments raised in the applications for rehearing and are of the opinion that good cause has been established to modify D.06-04-073 to clarify certain aspects of the settlement agreement and our Decision, as specified in the ordering paragraphs of this Order. In summary, we will modify the Decision to: 1) add an ordering paragraph to memorialize Fruitridge Vista's commitment under the settlement to annually invest specified revenues in the utility system; 2) clarify the terms of the settlement regarding the use of specified funds which may be received from Fruitridge Vista's pollution lawsuit and included in rate base; and 3) clarify that while the Commission can not lawfully bind future Commissions, it is this Commission's intent that future Commissions honor the terms of the approved settlement and the ratemaking treatment approved by the Decision. Rehearing of D.06-04-073, as modified, is denied.

II. DISCUSSION

A. Standing to File an Application for Rehearing of Assembly Member Jones, David Tamayo, and Paul and Debra McVay.

Assembly Member Jones, David Tamayo ("Tamayo"), and Paul and Debra McVay ("the McVays"), contend that each has standing to seek rehearing under the applicable statute and rule. For the reasons stated below we find that only Tamayo qualifies for standing to file an application for rehearing.

Section 1731(b) governs standing to file an application for rehearing and provides in pertinent part:

> After any order or decision has been made by the Commission, any party to the action or proceeding, or any stockholder or bondholder or other party pecuniarily interested in the public utility affected, may apply for a rehearing…

(Pub. Util. Code, § 1731, subd. (b).)

In addition, Commission Rule of Practice and Procedure 54 provides in pertinent part:

> In an investigation or application proceeding, or in such a proceeding when heard on a consolidated record with a complaint proceeding, an appearance may be entered at the hearing without filing a pleading.…a person or entity in whose behalf an appearance is entered in this manner becomes a party to and may participate in the proceeding to the degree indicated by the presiding officer.

(Rule 54 of the Commission's Rules of Practice and Procedure, Code of Regs., tit. 20, § 54.)

Assembly Member Jones is the legislative representative for the Ninth District encompassing Fruitridge Vista's service area. While the Assembly Member did participate at the March 2006 evidentiary hearing, he did so as a witness for DRA. Participating as a witness *for* a party, however, is not equivalent to entering an appearance *as* a party in a manner to qualify under Rule 54. Thus, despite Assembly Member Jones official status and acknowledged interest in the proceeding, he does not qualify for standing to file an application for rehearing of D.06-04-073.

Tamayo is President of the Fruitridge Vista Community Association. A review of the record indicates that Tamayo filed a formal appearance at the evidentiary hearing and qualifies as a party for purposes of section 1731.

The McVays are ratepayers of Fruitridge Vista and thus, claim to be "pecuniarily interested" for purposes of section 1731.[5] However, we have consistently determined that the statutory standard of being "pecuniarily interested" is not satisfied merely by the existence or possibility of financial harm as a ratepayer, competitor, or beneficiary of a utility program.[6] Therefore, the McVays do not have standing to file for rehearing of D.06-04-073.

For the above stated reasons, we dismiss the joint application for rehearing as to Assembly Member Jones and the McVays because they do not meet the criteria for standing under section 1731. Because the substantive issues in question will continue to be addressed though Tamayo, the interests of the Assembly Member and the McVays should not be harmed by the recommended dismissal. For purposes of this Order, the joint application for rehearing will be referred to in only the name of Tamayo.

B. $1.98 Million Addition to Rate Base

The Decision authorizes a $1.98 million addition to rate base associated with the buy-in fees for purchasing 1.13 million gallons per day ("MGD") of water from the City of Sacramento.[7] Under the settlement, up front funding for the $1.98 million will be

[5] Debra McVay also testified as a witness for DRA. However, as previously discussed, appearing as a witness for a party is not sufficient to acquire individual party status or standing.

[6] See *In the Matter of the Application of AT&T Communications of California, Inc., a Corporation, for Authority to Increase Rates and Charges Applicable to Telecommunications Services Furnished Within the State of California* [D.88-08-066] (1988) 29 Cal.P.U.C.2d 177; 1988 Cal.PUC LEXIS 583, ** 1-2; *So. Pac. Transportation Co. Motion to Rescind Order Granting Peninsula Commute and Transit Committee Petition for Rehearing of D.81188 Granted* [D.82043] (1973) 76 Cal.P.U.C. 2; 1973 Cal.PUC LEXIS 964, * 3; *Application of Pacific Gas and Electric Company for Authorization to Sell Certain Generating Plants and Related Assets Pursuant to Public Utilities Code Section 851* [D.99-06-064] (1999) 1 Cal.P.U.C.3d 267; 1999 Cal.PUC LEXIS 321, * 1.

[7] Fruitridge Vista has an existing rate base of $1 million. The Decision provides that $1.98 million of the total $12 million settlement costs will be included in Fruitridge Vista's rate base at the currently authorized 11% rate of return. (D.06-04-073, pp. 18, 24 [Finding of Fact Number 20.].) The Decision authorizes an offset rate increase of $4.38 per month associated with $1.98 million addition. (D.06-04-073, pp. 10, 24 [Finding of Fact Number 22.].)

provided through a financing agreement with the City of Sacramento to be paid back by an offset rate increase.

Tamayo and DRA contend the Decision contravenes basic ratemaking principles on the grounds that: 1) rate base and associated return is to be calculated based on capital contributed by the utility or its shareholders; and 2) public funds may not be included in rate base. DRA individually also contends that: 3) the record does not support that the City financing agreement is either forthcoming or necessary; and 4) the Decision improperly authorizes an offset rate increase. (Tamayo Rhg. App., pp. 8-13 / DRA Rhg. App., pp. 11-16.) We are not persuaded there is merit to these arguments.

1) Contributions to Rate Base

Tamayo and DRA argue that it is improper to grant rate base treatment for monies derived from the financing agreement / offset rate increase because basic ratemaking principles establish that a utility is only entitled to include in rate base and earn a return on capital contributed by the utility or its shareholders. (Tamayo Rhg. App., pp. 8-11 / DRA Rhg. App., p. 15.)

Tamayo relies on three cases to support this argument.[8] In our view, these cases do not establish that it's impermissible to authorize rate base and return where the contribution is received from sources other than a utility or its shareholders. The cases instead disallowed additions to rate base (and associated return) because profits were based on over collections, savings, and windfalls accumulated by the utility.

Our Decision is consistent with the primary requirement of these cases that the amount added to rate base be devoted to public use and reflect the actual expense to the utility. Here, the $1.98 million will be spent to provide water supply for Fruitridge

[8] Citing to *Southern California Edison Company v. Public Utilities Commission* ("*Edison v. PUC*") (1978) 20 Cal.3d 813; 1978 Cal. LEXIS 203; *Southern California Gas Company v. Public Utilities Commission* ("*SoCalGas v. PUC*") (1979) 23 Cal.3d 470; 1979 Cal. LEXIS 210; and *City and County of San Francisco v. Public Utilities Commission* ("*City and County of SF v. PUC*") (1971) 6 Cal.3d 119; 1971 Cal. LEXIS 205.

Vista's existing customers (as well as associated infrastructure tie-ins with the City of Sacramento), and is thus clearly devoted to public use. Further, this amount is Fruitridge Vista's actual cost to obtain the water and make associated infrastructure improvements. No party established the $1.98million will result in an over collection, savings or windfall.

Our Decision also took into account that general ratemaking practice under Standard Practice U-27-W[9] allows water purchase buy-in costs to be included in rate base as an off-settable expense. We have previously found that water should be considered to be real property, and that the purchase of water rights is a permissible element of rate base.

Finally, even if the authorized funding method departs from certain general ratemaking practices, we may properly exercise our discretion to apply varying ratemaking treatment when circumstances warrant. It is not unlike our discretion to depart from general rules or precedent to reach different conclusions in different cases as a matter of policy and because of their unique facts.[10]

We are convinced that circumstances peculiar to this proceeding and characteristics of the settlement support any departure authorized by D.06-04-073. For example, this proceeding did not involve a routine rate application. Rather, we were called to address an extraordinary and critical situation involving an imminent moratorium on water service to existing customers and attendant health and public safety

[9] Standard Practice for Processing Consumer Price Index, Rate Base and Expense Offset Rate Increases and Amortizing memorandum, Reserve and Balancing Accounts, Standard Practice U-27-W. (See Standard Practice U-27-W, pp. 2-4.)

[10] As stated in *Postal Telegraph-Cable Company v. Railroad Commission* ("*Postal Telegraph*") (1925) 197 Cal. 426; 1925 Cal. LEXIS 251. ** 7-8: "The departure by the Commission from its own precedent or its failure to observe a rule ordinarily respected by it is made the subject of criticism, but our reply is that this is not a matter under the control of this court. We do not perceive that such a matter either tends to show that the Commission had not regularly pursued its authority, or that said departure violated any right of the petitioner guaranteed by the state or federal constitution. Circumstances peculiar to a given situation may justify such a departure."

risks. The circumstances required an immediate solution capable of addressing a number of problems.

The settlement offered an immediate and comprehensive solution which includes the resolution of all the formal complaints against Fruitridge Vista, permits Fruitridge Vista to comply with the multiple objectives required under the DHS and RWQCB Orders, and allows Fruitridge Vista to receive support from the City and County of Sacramento. Failure of any term or component of the settlement would defeat achieving any immediate remedy for Fruitridge Vista or its customers.

Moreover, we were persuaded that Fruitridge Vista's current rate base of $1 million is inadequate to allow Fruitridge Vista to implement and operate the system improvements required to comply with the RWQCB and DHS orders and therefore, some addition to rate base was necessary. Even with the authorized rate increase, Fruitridge Vista's customers will continue to pay lower rates in comparison to other water systems in the Sacramento area. (D.06-04-073, pp. 10-11, 17.)

The settlement commits Fruitridge Vista to make annual investments in the utility system of $80,000 per year with the revenues that it collects which exceed the payments due to the City of Sacramento and associated taxes. While our Decision recognizes this commitment, we agree with Tamayo that a corresponding ordering paragraph reflecting this commitment should be added and we will modify the Decision accordingly, as set forth below in the ordering paragraphs of this Order.

2) Public Funds in Rate Base

Tamayo and DRA contend that to the extent the $1.98 million is funded by the DHS State Revolving Fund ("Revolving Fund") or Drinking Water Treatment and Research Fund ("Water Treatment Fund") monies, the Decision violates Commission precedent establishing that public funds such as state grants or customer donations can not be included in rate base. (Tamayo Rhg. App., pp. 11-12 / DRA Rhg. App., p. 15.)

Most notably, Tamayo and DRA rely on *Order Instituting Rulemaking on the Commission's Own Motion to Develop Rules and Procedures to Preserve the Public*

Interest Integrity of Government Financed Funding, Including Loans and Grants, to Investor-Owned Water and Sewer Utilities [D.06-03-015] (2006) __ Cal.P.U.C.3d __; 2006 Cal.PUC LEXIS 95. In D.06-03-015 we adopted rules regarding the ratemaking treatment of state grant funds received by all classes of water companies. With the goal of ensuring the public interest integrity of such funds, we stated that investor-owned water utilities and their shareholders will not be able to earn a return or profit through the receipt of public funds.[11]

Tamayo and DRA's concern is unwarranted and appears to be based on a misunderstanding of the settlement terms and structure. While the settlement involves several sources of money to be allocated between various elements of the comprehensive solution, neither Revolving Fund nor Water Treatment Fund monies will contribute to the $1.98 million purchase water costs with the City of Sacramento.

Under the settlement and our Decision, the total cost of the right to purchase water from the City of Sacramento is approximately $5.7 million. Approximately $3.7 million of that amount will be paid by Revolving Fund and/or Water Treatment monies allocated to obtain 2.11 MGD of purchase water. The remaining amount, approximately $1.98 million will come from the financing agreement between Fruitridge Vista and the City of Sacramento and will pay for up to 1.13 MGD of purchase water. Nothing in the settlement provides that any of the Revolving Fund or Water Treatment Fund monies can be applied to pay for the $1.98 million amount which is authorized to be included in rate base. Thus, we authorized an offset rate increase to pay back the City for the $1.98 million financing agreement (i.e., loan) expense. (D.06-04-073, p. 18.)

[11] (D.06-03-015, *supra*, 2006 Cal.PUC LEXIS 95, ** 2, 16 [Conclusion of Law Number 2.].)

3) Record to Support the Financing Agreement

DRA contends that the Decision errs because there is no record to support the conclusion that a financing agreement with the City of Sacramento is necessary or even likely to happen. (DRA Rhg. App., pp. 11-14.)

DRA claims its testimony in the proceeding established that the financing agreement is unnecessary, and that we failed to give adequate weight to its argument. We considered DRA's testimony, but ultimately rejected the position because it was incorrectly based on the premise that the financing agreement is unnecessary because Revolving Fund and Water Treatment Fund monies will fully cover the water purchase by-in fees with the City. As discussed above in this Order, the settlement provides for three separate sources of funding which each appear to be independently necessary to cover the full cost of purchase water: Revolving Fund monies, Water Treatment Fund monies, and the financing agreement.

DRA further claims that since the record does not contain an executed financing agreement, there is no record to support a conclusion one will in fact come to fruition. To the contrary, the record reflects that: execution of a water agreement between the City and Fruitridge Vista is an express condition of the settlement; the City sent a commitment letter to the Sacramento Housing and Redevelopment Agency attesting to its intent to provide wholesale water to Fruitridge Vista; and the Sacramento Housing and Redevelopment Agency, and the County of Sacramento both testified in support of the settlement, and further attested to the fact that the County's Board of Supervisors support the settlement. We believe these entities, as parties who participated in the settlement negotiations and terms it would impose, have a vested interest in assuring that the City fulfills its commitment to bring the financing agreement to fruition.

While DRA may prefer the assurance of having an executed agreement already in place, it was not prerequisite to approval of the settlement as DRA suggests. We had ample basis upon which to reasonably rely, and conclude that a financing agreement will be executed and that that condition of the proposed settlement will be fulfilled.

4) Offset Rate Increase

DRA contends the Decision errs in granting an offset rate increase on the grounds that we misapplied Standard Practice U-27-W and denied ratepayers adequate due process. (DRA Rhg. App., p. 16.)

Standard Practice U-27-W contemplates offset rate increases for expenses that are considered beyond the control of the utility, and in the public interest to allow the utility to recover. In this instance, DRA claims the $1.98 million purchase water expense was not beyond the control of the utility because Fruitridge Vista could choose to pay for it with the public funds instead of the financing agreement.

To support its objection, DRA would need to establish that Fruitridge Vista does not need to purchase water from the City in order to meet its water supply needs. However, DRA does not make that argument, instead arguing that the utility could opt to pay for the expense in some other manner. Neither claim is correct.

The record is replete with facts to justify an offset rate increase for the purchase water expense as beyond Fruitridge Vista's control. According to the RWQCB and DHS Orders, Fruitridge Vista is significantly short of its existing water supply needs and has no capability of meeting that need or of storing water in its own distribution system. Additional outside sources of water are required. The DHS Order explicitly directs Fruitridge Vista to pursue the long-term purchase of surface water from the City of Sacramento, and DRA's own testimony corroborates that need and supports that option.

While DRA is critical of Fruitridge Vista's past failures, that does not obviate the fact that there remained no other immediate source of water that could be pursued. Therefore, at this juncture, the need to incur the $1.98 million expense is beyond Fruitridge Vista's control. Further, we satisfied the second element of justifying the rate base offset under the Standard Practice in finding that the expense is in the public interest. (D.06-04-073, p. 18.)

DRA is also wrong that Fruitridge Vista could choose to use the public funds to pay for this portion of the buy-in fee. As previously discussed, the Revolving Fund and Water Treatment Fund monies are specifically allocated for other portions of the total purchase water cost and will not cover the $1.98 million portion.

With respect to the issue of due process, DRA argues that as a policy matter, it prefers that utilities "come in and get authorization" for offset rate increases such as this which are over 25% of the utility's annual income. DRA claims we effectively denied ratepayers their due process and opportunity to be heard by waiving the requirement that Fruitridge Vista show the reasonableness and justification for the ratemaking treatment.

As we specifically noted in our Decision, DRA agreed during hearings that regardless of its policy preference, Class B water utilities are not required to come in to obtain approval for this type of rate increase. Though Class A water utilities need a Commission decision to authorize a rate base offset, Standard Practice U-27-W provides that Class B, C, and D water companies do not. Consequently, the offset rate increase granted in this proceeding was subject to greater due process than is typically necessary or accorded, in that here we received testimony and conducted evidentiary hearings on the proposed settlement, then issued a formal decision affirming the reasonableness and justification for the authorized rate increases.

C. Procedural Requirements

Tamayo contends that the Decision errs because we failed to insure adequate due process for Fruitridge Vista's customers because: 1) Fruitridge Vista did not provide its customers with notice of the proposed rate increase in accordance with the standard under section 454(a); and 2) the Commission violated Rule 6.3 of the Commission's Rules of Practice and Procedure by failing to amend the scoping memo to identify a potential settlement and rate increase as among the issues to be considered. (Tamayo Rhg. App., pp. 13-17.)

1) Notice of Proposed Rate Increase

Tamayo acknowledges that Fruitridge Vista provided its customers with notice of the potential rate increases once the settlement had been submitted for Commission consideration. However, Tamayo argues that because the proceeding ultimately resulted in a rate increase, it was effectively transformed into a general rate case ("GRC") and thus, Fruitridge Vista was required to provide notice pursuant to the procedures under section 454(a).

Section 454(a) provides in pertinent part:

> …Whenever any electrical, gas, heat, telephone, water, or sewer system corporation files an application to change any rate, **other than a change reflecting and passing through to customers only new costs to the corporation which do not result in changes in revenue allocation, for the services or commodities furnished by it**, the corporation shall furnish to its customers affected by the proposed rate change notice of its application to the commission for approval of the new rate.

(Pub. Util. Code, § 454, subd. (a) (emphasis added).)

Section 454(a) applies when a utility files an application for approval of GRC and provides specific timing and content requirements for the notice to be provided to customers. Those notice requirements are geared to the typical 12 to 18-month proceeding timeline for applications which review utility operations and expenses on a company-wide basis.

In this proceeding Fruitridge Vista did not submit an application for approval of GRC rate increase. It submitted an application for approval of a moratorium on new service. The notice periods under section 454(a) were not applicable because D.06-04-073 does not grant a rate increase reflecting a company-wide review. Our Decision authorizes rate increases to purchase water, construct new wells, and construct associated infrastructure. These costs are the "passing through of new costs" for specific services or commodities which are explicitly exempted under the statute from the notice

requirements. Authorization for such rate increases are often submitted by advice letter and subject to only nominal notice requirements pursuant to General Order 96-A.[12]

Nevertheless, Tamayo contends that under the standards expressed in *Lockyer v. San Francisco* (2004) 33 Cal. 4th 1055; 2004 Cal. LEXIS 7238; and *Re Southern California Gas Company* [D.92-06-067] (1992) 44 Cal.P.U.C.2d 742; 1992 Cal.PUC LEXIS 999, we failed to insure due process had been provided for Fruitridge Vista's customers.

Neither case is applicable here. Unlike the situation in *Lockyer v. San Francisco*, this proceeding did not involve a unilateral determination without affording the opportunity for others to be heard. We received evidence and written testimony on the settlement, and held evidentiary hearings during which parties and others had the opportunity to be heard on the issues. Further, unlike the situation in *Re Southern California Gas Company*, in this proceeding a determination was not reached without holding hearings. We did hold evidentiary hearings prior to reaching a determination.[13]

Despite the fact notice and opportunity to be heard was provided in this proceeding, Tamayo argues that the brief time frame between the notice (given after submission of the proposed settlement in February 24, 2006) and the date of the hearings (March 13, 2006), did not give customers ample time to prepare and meaningfully participate to present alternatives for Commission consideration. (Tamayo Rhg. App., p. 16.)

We acknowledge that the extraordinary circumstances of this case resulted in treating the settlement in an expedited manner. (D.06-04-073, p. 8.) However, testimony demonstrates that Fruitridge Vista's customers received notice of the proposed settlement and understood that it involved a potential rate increase. We are not aware of any request

[12] See General Order 96-A, Section III G., Section VI.
[13] Tamayo also generally references *MCI Telecommunications Corp. v. FCC* (1995) 57 F.3d 1136; 1995 U.S. App. LEXIS 1500. This case is not relevant because it involves whether notice of a rulemaking provided in the footnote of a decision was adequate.

by a customer for additional time to prepare or consider other alternatives. Moreover, we did consider the alternative presented by DRA and Assembly Member Jones (as advocated by Tamayo in its application for rehearing), both of whom purport to represent customer interests, and we rejected that alternative as unworkable. (D.06-04-073, pp. 4, 20-22.)

2) Scoping Memo

According to Tamayo, the Scoping Memo for this proceeding did not include either the settlement or rate increase as issues for consideration. Tamayo contends that by failing to issue an amended Scoping Memo or ALJ Ruling to broaden the scope of issues, the Commission violated Rule 6.3. (Tamayo Rhg. App., p. 17.)

Rule 6.3 Scoping Memos requires in pertinent part that after the prehearing conference ("PHC"), if one is held, the assigned Commissioner shall rule on the scoping memo for the proceeding and "finally determine the schedule…and issues to be addressed."

In this proceeding a PHC was held on December 6, 2005, during which parties were properly advised that the PHC should identify disputed material issues of fact to be summarized in the assigned Commissioner scoping memo. During the PHC it was also discussed that mediation would take place, that settlement was a potential outcome, and that rate increases could be an inevitable outcome to any solution to be reached in this proceeding.

The Scoping Memo and Ruling of the Assigned Commissioner was subsequently mailed to those who attended and entered appearances at the PHC. In memorializing the PHC discussions, the Scoping Memo states that the parties would proceed to participate in the Commission's mediation process, and issues to be considered would include "[H]ow will the utility and ratepayers pay for any additional sources of water supply?"

While the Scoping Memo does not use the terms "settlement" or "rate increase" and thus, could have been more clear, these issues were identified and known

by the parties as within the scope of the proceeding. Both issues were explicitly discussed during the PHC as potential outcomes to the proceeding. It is incorrect to suggest that a settlement is not inherent to a mediation process, or that a rate increase is not inherent to the issue of how the utility and ratepayers will pay for additional water supply.[14]

D. Findings of Fact on Material Issues

Tamayo contends that the Decision fails to include findings of fact and conclusions of law on all material issues as required by section 1705. In particular, Tamayo argues that while the Decision makes adequate findings as to the "ultimate issues," it does not make the requisite findings on material issues that must be resolved to reach each ultimate finding. (Tamayo Rhg. App., pp. 17-22.)

Section 1705 provides in pertinent part that a Commission decision:

> shall contain, separately stated, findings of fact and conclusions of law on all issues material to the order or decision.

(Pub. Util. Code, § 1705.)

Tamayo bases its contention on four cases where the courts found that Commission decisions failed to fulfill the requirement of section 1705.[15] We do not agree that these cases support a claim that our findings in this Decision are inadequate.

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[14] Tamayo also suggests that the scoping memo should have included a statement that the assigned Commissioner may "modify the scope of issues following receipt and evaluation of additional information and testimony." (citing to *Order Instituting Rulemaking on the Commission's own Motion for the Purpose of Considering Policies and Rules Governing Utility Constructing Contracting Processes* [D.04-12-056] (2004) __ Cal.P.U.C.3d __, p. 7 (slip op.).) This criticism is not persuasive. It is within our discretion and general practice to issue a modified or amended scoping memo if new issues are added for consideration in a proceeding. However, D.04-12-056 does not require us to do so, or establish a requirement that the initial scoping memo memorialize such potential.

[15] Citing to *Greyhound Lines Inc. v. Public Utilities Commission* ("*Greyhound Lines*") (1967) 1967 Cal. LEXIS 390; *California Manufacturers Association v. Public Utilities Commission* ("*California Mfrs. Assn*.") (1979) 24 Cal.3d 251; 1979 Cal. LEXIS 256; *California Motor Transport Company v. Public Utilities Commission* ("*California Motor Transport*") (1963) 59 Cal.2d 270; 1963 Cal. LEXIS 159; and *Associated Freight Lines v. Public Utilities Commission* ("*Assoc. Freight Lines"*) (1963) 59 Cal.2d 583; 1963 Cal. LEXIS 185.

Of the cited cases, *California Motor Transport* is most closely aligned to the situation in this proceeding for purposes of identifying the relevant material issues.[16] In *California Motor Transport*, our finding generally granted a certificate of public convenience and necessity ("CPCN"), a determination similar to what Tamayo's refers to in this proceeding as an "ultimate issue." The court took issue with the finding because we did not further articulate what factors we deemed material to that ultimate determination and state corresponding findings.[17]

In this proceeding, the issue to be resolved was whether to approve the proposed settlement agreement. Using the rationale in *California Motor Transport*, the settlement would be the "ultimate issue" to be determined, analogous to the issue of whether to grant a CPCN. For a settlement involving a Class B water utility, there is no rule or statute establishing the factors that are then material to determining whether to adopt a settlement. Nevertheless, we exercised caution and applied the criteria under Rule 51.1(e) Stipulations and Settlements, which provides that in determining whether to approve a settlement, the Commission must find that it is: 1) reasonable in light of the whole record; 2) consistent with the law; and 3) in the public interest. Our Decision complies with section 1705 and the case law because by using the Rule 51.1criteria we identified the factors we deemed material for purposes of determining whether to approve the settlement (the "ultimate issue"), and then made the requisite findings and conclusions. (D.06-04-073, pp. 25 [Conclusion of Law Numbers 1, 2, 4, 5.].)

According to Tamayo, we were also required to include findings "concerning the substantial uncontroverted evidence" introduced by DRA and Assembly Member Jones that less costly ratemaking alternatives are available for timely addressing the company's water quality and supply deficiencies. (Tamayo Rhg. App., p. 22.)

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[16] The factual situations and holdings in *Greyhound Lines* and *California Mfrs. Assn.* are more general and provide less guidance in this proceeding. Decision 06-04-073 complied with the general requirement in these decisions because the Decision did include findings regarding the material issue, e.g., whether to approve the settlement.

[17] *California Motor Transport, supra*, 1963 Cal. LEXIS 159, ** 6-7.

It remains unclear what evidence of less costly alternatives Tamayo has in mind or where such evidence was submitted in the record. Indeed, Tamayo's own statement calls the proposed alternative "elegant in its simplicity, " recommending only that we "authorize all necessary system improvements and financing…but defer any ratemaking treatment of funds provided for such investments to a subsequent rate case…" (Tamayo Rhg. App., p. 27.) The alternative offered no tangible or less costly solution that could be selected and applied in a timely manner to solve the immediate water supply and safety problems. Thus, we reasonably rejected such a proposal as unworkable. (D.06-04-073, pp. 4, 20-21.)

Finally, Tamayo argues the Decision should have made findings regarding a number of other "important issues" including: facts regarding why $1.98 million should be included in rate base; facts regarding how funds received by Fruitridge Vista as a result of pollution litigation will be invested or should be allocated between ratepayers and shareholders; and why we rejected certain positions advanced by DRA and Assembly Member Jones in their testimony. (Tamayo Rhg. App., pp. 18, 21-22.)

Even if we could have included findings on such issues, Tamayo offers no basis to establish why any of the issues it raises are material for purposes of approving the proposed settlement. As stated in *Re San Diego Gas & Electric Company* [D.03-08-072] __ Cal.P.U.C.3d __; 2003 Cal.PUC LEXIS 1136, the purpose for having findings on material issues in Commission decisions is to:

> afford a rational basis for judicial review and assist the reviewing court to ascertain the principles relied upon by the Commission and to determine whether it acted arbitrarily, as well as assist parties to know why the case was lost and to prepare for rehearing or review, assist others planning activities involving similar questions, and serve to help the Commission avoid careless or arbitrary action.

(D.03-08-072, *supra*, 2003 Cal.PUC LEXIS 1136, * 8 (citations omitted.).)

In complying with this purpose, however, we have found that: "[s]ection 1705 does not require the Commission to make express legal and factual findings as to

each and every issue or sub-issue raised by a party to a Commission proceeding. Rather, it only requires sufficient findings and conclusions to assist the court in ascertaining that the Commission acted properly and to assist parties in preparing for rehearing or court review." (*Id.*, * 8.)

In this proceeding we identified the material factors for purposes of resolving the ultimate issue and stated corresponding findings and conclusions as required by section 1705. Consequently, we provided the basis to permit a reviewing court or parties to ascertain the principles we relied upon to ensure that the matter was not determined arbitrarily.

E. $5 Million Addition to Rate Base

Tamayo and DRA allege that the Decision unlawfully authorizes a $5 million addition to rate base in connection with Fruitridge Vista's pollution lawsuit.[18] In particular, they claim: 1) there is no record to support that Fruitridge Vista will in fact receive any pollution lawsuit damages or that it will prudently spend that award on infrastructure improvements; and 2) it is premature to assign proceeds from Fruitridge Vista's pollution lawsuit to shareholders. (Tamayo Rhg. App., pp. 26 / DRA Rhg. App., pp. 17-19.)

1) Record Regarding the Addition to Rate Base and Nature of Expenditures

Tamayo and DRA state that it's speculative whether any damage awards will be received and there is no assurance Fruitridge Vista would use such awards to improve facilities rather than squander them on imprudent expenditures. Accordingly, they argue the addition to rate base is not supported by the record as required by section 1701.3(e).[19] (Tamayo Rgh. App., p. 23 / DRA Rhg. App., p. 17.)

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[18] In *Fruitridge Vista Water Compay v. Arco* (Sacramento County Superior Court Case No. 02AS00535), Fruitridge Vista is pursuing damages for the MTBE pollution in 3 of its 4 permanently disabled wells.

[19] Section 1701.3(e) provides in pertinent part that a Commission decision must be "based on evidence in the record."

While it is true that damage awards may never materialize, we properly accounted for that situation by not immediately adding any associated amount to rate base regardless of eventual recovery (or not) by the utility. Instead, amounts up to $5 million can be included in rate base only if and when actually received by the utility, and only after the money is actually invested in infrastructure improvements.

Moreover, we concluded the settlement provides assurance that the amount in question would be prudently spent on identified solution components. In particular, the settlement states that pollution award amounts which qualify for funding under Health & Safety Code section 116367(f) are specifically earmarked to reimburse DHS for Water Treatment Fund grant monies. The grant funds (and thus the damage awards, by extension) are specifically allocated for the replacement of water supply from wells 1 and 2, testing and destruction of wells 1, 2, 11, and 12, and to otherwise cure the existing supply and pressure problems caused by the MTBE contamination. We see no flexibility for Fruitridge Vista to divert and imprudently squander the monies rather than invest them as specified under the settlement. Nevertheless, we agree the Decision could more clearly explain the ratemaking treatment for the $5 million and how that money will be spent. We will modify the Decision accordingly as set forth below in the ordering paragraphs of this Order.

2) Allocation of Pollution Litigation Proceeds

Tamayo and DRA allege the Decision errs because it prematurely allocates potential litigation damages to Fruitridge Vista's shareholders rather than ratepayers when the same issue is pending in another proceeding. In particular, DRA suggests no determination can be reached because we are currently considering a similar issue in the San Gabriel Water-Fontana District rate case. (Tamayo Rhg. App., p. 26 / DRA Rhg. App., pp. 18-19.)

Our pending action in another proceeding does not impede our ability to make a determination in this case. We have previously found that we are free to deal with the ratemaking treatment of damage awards in contamination lawsuits and

settlements on a case-by-case basis.[20] In addition, the question of how to allocate proceeds becomes a matter for scrutiny where it involves the distribution of excess proceeds, e.g., funds no longer needed for the costs of actions necessary and related to correct the contamination. That is not the case here.

As previously discussed in this Order, rate base treatment is authorized only for proceeds which are needed for, and would be specifically used for, the infrastructure improvements required to correct problems resulting from the MTBE contamination. There is no issue to be determined regarding how to allocate excess proceeds. Further, we note that Fruitridge Vista's shareholders have contributed all of the costs of the pollution lawsuit. Thus, it is reasonable to conclude that awards should flow to Fruitridge Vista's shareholders.

F. Just and Reasonable Rates

Tamayo contends that the Decision is unlawful because we failed insure that rates in connection with the $1.98 million and $5 million additions to rate base are just and reasonable as required by section 451,[21] and failed to fulfill our duty to consider reasonable alternatives to reduce rates. (Tamayo Rhg. App., pp. 24, 27-29.)

Consistent with the intent of section 451, in this proceeding we conducted hearings specifically to determine the reasonableness of the settlement and associated rate increases. We received and considered evidence regarding a number of relevant issues including: 1) necessary infrastructure and water supply improvements; 2) the financial condition of Fruitridge Vista's customer base; 3) the fact that Fruitridge Vista has not had

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[20] See *In the Matter of the Application of Southern California Water Company (U 133 W) for an Order Pursuant to Public Utilities Code Section 851 Approving a Settlement Agreement that Will Convey Water Rights in the Culver City Customer Service Area* ("*So Cal Water Settlement Decision*") [D.04-07-031] (2004) __ Cal.P.U.C.__; 2004 Cal.PUC LEXIS 368.

[21] Section 451 provides in pertinent part:

> All charges demanded or received by any public utility…shall be just and reasonable.

(Pub. Util. Code, § 451.)

a GRC and associated rate increase in 6 years; 4) the rate impact of the authorization granted in our Decision; and 5) the rates for water service in nearby water districts. Ultimately, we concluded that on balance, the outcome in the proceeding was reasonable. (D.06-04-073, pp. 24-25 [Conclusion of Law Numbers 3, 4, 7.].)

Tamayo also asserts that our action contravenes case law which requires that we consider alternatives which could reduce rates and costs to utility ratepayers.[22] While we endeavor to consider all avenues to reduce customer rates, these cases do not show that we failed in our duty in this proceeding. In the cited cases, existing, substantive, alternative methodologies were available to determine whether lower rates could be achieved. In this proceeding, however, no substantive alternatives were proposed that could have allowed us to determine whether other means were available to reduce the proposed rates. The only alternative we were offered was to simply defer any determination regarding rate impacts to some future date. (Tamayo Rhg. App., p. 27.) We properly considered this alternative, but concluded such a result would create too much uncertainty for everyone involved, and could potentially defeat reaching a comprehensive settlement, thus removing any foreseeable remedy and perpetuating the existing health and safety risks if the company's water system is not immediately repaired. Such a result is clearly contrary to the public interest. (D.06-04-073, pp. 4, 20-22.) Neither *City and County of SF v. PUC* nor *City of LA v. PUC* establish an obligation to defer a determination on the grounds that unidentified alternatives might be fashioned in the future which could have a different rate impact.

G. Section 701.10 Policy Regarding Water Service

Tamayo broadly claims that the Decision errs because it violates section 701.10 subds. (b) and (f) by failing to minimize the long-term costs of reliable water, and

[22] Citing to *City and County of SF v. PUC, supra*, 1971 Cal. LEXIS 205; and *City of Los Angeles v. Public Utilities Commission* ("*City of LA v. PUC*") (1975) 15 Cal.3d 680; 1975 Cal. LEXIS 262.

failing to set rates based on the actual cost of providing water service. (Tamayo Rhg. App., p. 30.)

Section 701.10 provides in pertinent part:

> The policy of the State of California is that rates and charges established by the commission for water service provided by water corporations shall do all of the following:
>
> (b) Minimize the long-term cost of reliable water service to water customers.
>
> (f) Be based on the cost of providing the water service including, to the extent consistent with the above policies, appropriate coverage of fixed costs with fixed revenues.

(Pub. Util. Code, § 701.10, subds. (b) and (f).)

Tamayo's application for rehearing offers no analysis, but merely references the statute and reiterates its position that the $1.98 million and $5 million additions to rate base have not been deemed reasonable. As previously discussed in this Order, this allegation is not compelling because it simply ignores the actions taken to review the reasonableness of the settlement and attendant rate increases and our finding in that regard.

H. Binding Future Commissions

Tamayo contends the Decision errs by adopting provisions of the settlement which provide that the adopted ratemaking treatment for the $1.98 million and $5 million additions to rate base are not subject to future litigation. Tamayo argues that by failing to modify these provisions, the Decision effectively purports to bind future Commissions contrary to section 1708[23] and Commission precedent.[24] (Tamayo Rhg. App., pp. 30-31.)

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[23] Section 1708 provides in pertinent part:

> The commission may at any time, upon notice to the parties, and with opportunity to be heard as provided in the case of complaints, rescind, alter, or amend any order or decision made by it.

(Pub. Util. Code, § 1708.)

[24] Citing to *Re pacific Gas and Electric Company* ("*Diablo Canyon*") (1988) 30 Cal.P.U.C.2d 189, 223-224, 284; 1988 Cal.PUC LEXIS 886.

Contrary to Tamayo's suggestion, the provisions in question operate to bind the Settling Parties, not the Commission. Nothing precludes parties to a settlement from agreeing to be bound to the terms of the agreement should those issues arise in future related proceedings, and Tamayo offers no basis to establish such terms are unlawful.

We have acknowledged that unless the Commission is itself a party to a settlement agreement, it cannot as a matter of law bind future Commissions to the terms of a settlement.[25] That said, in this proceeding we adopted the settlement believing it to be just and reasonable, and presenting the least cost and most comprehensive solution to a number of difficult problems facing the utility and its customers. It is our intent that future Commissions treat as lawful and effective the rates authorized by the Decision.[26] Nevertheless, we do find merit to clarifying our position and intent on this issue and so will modify the Decision accordingly as set forth below in the ordering paragraphs of this Order.

III. CONCLUSION

For the reasons specified above, D.06-04-073 is modified to clarify the settlement agreement and our Decision regarding specified issues as reflected in the ordering paragraphs of this Order. In addition, the joint application for rehearing is dismissed as to Assembly Member Jones and the McVays because they lack standing to seek rehearing. Rehearing of D.06-04-073, as modified, is denied.

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[25] See *Diablo Canyon, supra*, 30 Cal.P.U.C.2d 223-225; *Investigation of the Commission's Own Motion into the Desirability of Power Purchases From Cogeneration and Small Power Producers Located Outside of the Purchaser's Service Area or Outside of California and the Terms and Conditions Which Should be Applied to Such Purchases* [D.90-08-046] (1990) 37 Cal.P.U.C.2d 194; 1990 Cal.PUC LEXIS 727, * 6; *In Re Pacific Gas and Electric Company, Case No. 01-30923 DM* ("*Ch. 11 Bankruptcy Reorganization OII*") [D.04-03-009] (2004) __ Cal.P.U.C. 3d __; 2004 Cal.PUC LEXIS 72, * 3-5.

[26] It should be noted that pursuant to Rule 51.8, while the terms of the settlement are binding upon the parties in this proceeding, it does not constitute approval of, or precedent regarding, any principle or issue in the proceeding or in any future proceeding.

Therefore **IT IS ORDERED** that:

1. Modify D.06-04-073, page 27, to add a new ordering paragraph stating:[27]

> 4. Fruitridge Vista shall make annual investments in the utility system of at least $80,000 per year with the revenues it collects from ratepayers that exceed the payments due to the City of Sacramento and associated taxes on the buy-in fee associated with 1.13 MGD.

2. Modify text of D.06-04-073, page 16 to delete the last sentence.

3. Modify text of D.06-04-073, page 17 to delete the fist two indented paragraphs and replace with the following:

> DRA correctly noted that it is unknown whether any recovery will occur, how much any recovery will be, and when it might occur. DRA speculates it may take several months for the litigation between Fruitridge Vista and the polluters to conclude. If this is true, then it is unlikely that any rate base increase will occur.
>
> DRA also raises concerns that the treatment of court awarded damages might have been dealt with differently in a general rate case. While this is true, this decision approves as part of the overall settlement, a potential rate base increase up to $5 million only under strict conditions. Only if and when Fruitridge Vista recovers money from the pollution lawsuit and invests that money into system improvements as contemplated by the settlement agreement, in lieu of accepting DHS grant monies, would those investments be added to rate base. As conditions of receiving the rate base increase, the pollution lawsuit award must be received by Fruitridge Vista, it must be invested directly into plant, and not exceed $5 million. Further, 50% of any return earned from the amount included in rate base will be dedicated to system improvements.

[27] Associated with this modification, existing ordering paragraph number 4 should be renumbered as ordering paragraph number 5.

> We take into account that the DHS Order requires Fruitridge Vista to undertake a number of system improvements, many of which are already overdue. We expect DHS grant money will be needed in full for these improvements unless the pollution litigation is resolved at an earlier time. To the extent DHS money is used and later reimbursed from recoveries from the pollution lawsuit, the money will not be added to rate base without additional Commission proceedings.

4. Modify D.06-04-073, page 24, to revise finding of fact number 25 as follows:

> 25. If Fruitridge Vista recovers monies from alleged polluters in its pollution litigation, up to $5 million of that recovery which Fruitridge Vista invests in plant would be added to rate base at a 10% return.

5. Modify text of D.06-04-073, page 19, under Section 8 Discussion, to add a new final paragraph stating:

> We realize that Commission precedent establishes that we cannot bind the actions of future Commissions and we will not comment on the consequences of a future Commission's changing of the terms of the settlement. However, we believe the settlement is a fair, just, and reasonable compromise of many difficult and potentially costly problems facing Fruitridge Vista and its customers. We believe it is in the best interest of Fruitridge Vista and its customers that the settlement agreement be implemented as adopted by our decision. Therefore, we state our intent that all future Commissions recognize and give full consideration and weight to the fact that this settlement has been approved based on the expectations and reasonable reliance of the parties and this Commission that all of its terms and conditions will be implemented by future Commissions.

6. Modify D.06-04-073, page 26, to add a new conclusion of law number 10 stating:

10. This Commission cannot bind future Commissions in fixing just and reasonable rates for Fruitridge Vista. Nevertheless:

In approving this settlement, based on our determination that taken as a whole its terms produce a just and reasonable result, this Commission intends that all future Commissions should recognize and give full consideration and weight to the to the fact that this settlement has been approved based on the expectations and reasonable reliance of the parties and this Commission that all of its terms and conditions will be implemented by future Commissions.

7. Rehearing of D.06-04-073, as modified, is denied.

8. These proceedings, A.05-10-005, C.05-10-007, C.05-10-011, C.05-09-011, C.05-09-012, C.05-09-027, and C.05-11-015, are closed.

This order is effective today.

Dated September 21, 2006, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners